

Summary of Testimony of America's Community Bankers

**Presented by Kenneth J. Redding, President and CEO
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Presiding Officer Bovenzi, and staff of the Federal Deposit Insurance Corporation, I am Kenneth J. Redding, President and CEO of UniBank for Savings of Whitinsville, Massachusetts. I am here this morning representing America's Community Bankers. I want to thank the FDIC and Acting Chairman Gruenberg for calling this public hearing on this important issue.

ACB believes that depository institutions of all types should have the ability to choose the charter that best suits the needs of their customers and business model. While ACB supports the existence and viability of the ILC charter as an option, we oppose Wal-Mart's application for an ILC and federal deposit insurance for the following reasons.

First, we believe ILCs must operate under restrictions substantially similar to those Congress placed on unitary savings and loan holding companies organized after May 4, 1999. Restrictions on ILCs are now pending in Congress in H.R. 1224 and H.R. 3505, indicating clearly Congress' recognition of public policy concerns, and the FDIC should not act until Congress fully considers the issue.

Second, community banking is a vital sector of the U.S. economy. While ACB is committed to fair and open competition among all institutions, we note that some competitors of community banks operate with regulatory and tax advantages not available to community banks. For example, community banks bear a greater relative burden of regulatory costs compared to large banks.

To approve Wal-Mart's application today lays the groundwork for Wal-Mart to expand into full retail banking without additional regulatory approval, thereby further threatening the viability of community banks. Nothing would prevent Wal-Mart Bank from expanding its activities once this application is approved. In addition, we note Wal-Mart Bank reportedly has withdrawn its request for an exemption from the requirements of the Community Reinvestment Act (CRA) on the basis of its limited business model as submitted in its deposit insurance application, and now proposes to be fully subject to CRA requirements in a designated CRA-assessment area. This strongly suggests an intended retail strategy that would pit Wal-Mart

Bank against thousands of community banks, magnifying all of the inherent conflict of interest, competitive advantage and systemic risk concerns that we raise here today.

We are concerned that if the Wal-Mart Bank expands unchecked, the competitive advantages of the company will diminish competition in markets now served by community banks, thereby leaving local businesses that compete commercially with Wal-Mart with no community-based banking alternative. In addition, hundreds of ACB members banks enjoy good business relationships with Wal-Mart through agreements under which they lease space inside Wal-Mart stores. These relationships are good for community banks and customers of Wal-Mart. However, these community banks' business strategy is clearly at risk if their branches inside Wal-Mart were eventually displaced by Wal-Mart banks.

Finally, we believe that the size and concentration of a Wal-Mart Bank in the payment system, and deposit insurance fund more generally, present serious questions of systemic risk.

As just one example, according to Wal-Mart's application, its bank would process billions of transactions as a credit card acquirer for the merchandiser, Wal-Mart stores. With the Wal-Mart Corporation on both sides of these transactions, it would be challenging, and potentially impossible, to ensure that there would be effective firewalls against financial problems in the commercial store spreading to the Wal-Mart Bank. In such a scenario, with hundreds of billions of dollars passing through the Wal-Mart Bank system, the risk of disruption stemming from financial problems at Wal-Mart would be great.

We recognize the FDIC as a strong, effective and diligent regulator. However, allowing Wal-Mart to operate outside the statutory requirements that have been carefully crafted for other institutions is a risk in and of itself due to the extraordinary size of the company. This is a risk that the FDIC should avoid at all costs. Finally, the size of deposits that could be generated by Wal-Mart pose a threat of dilution to the deposit insurance fund. In the past, other large ILCs contributed to the dilution of the Bank Insurance Fund without contributing any reserves, thereby weakening the deposit insurance fund. This so-called "free-rider" problem cannot be permitted to continue – particularly with the size and scope of Wal-Mart's operations.

In conclusion, as this application represents a topic that is under active consideration by Congress and also presents an extraordinary and unusual set of facts and risks, ACB strongly urges the FDIC to disapprove the application at this time.

Testimony of
America's Community Bankers
on
Application for Federal Deposit Insurance for Wal-Mart Bank
before the
Federal Deposit Insurance Corporation
on
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Presiding Officer Bovenzi, and staff of the Federal Deposit Insurance Corporation, I am Kenneth J. Redding, President and CEO of UniBank for Savings of Whitinsville, Massachusetts. UniBank is a mutual institution with a charter history that dates back to 1865. UniBank has more than \$600 million in assets and is a diversified institution offering consumer and commercial products. UniBank originates mortgages nationwide and has seven bank branches in Massachusetts. Our mutual structure and commitment to our community make the bank an integral part of, and accountable to, our community. Last year we contributed in excess of 10 percent of our after tax profits to local charities and programs.

I am here this morning representing America's Community Bankers.¹ I am a member of ACB's Government Affairs Steering Committee. I want to thank the FDIC and Acting Chairman Gruenberg for calling this public hearing on this important issue.

ACB is pleased to have this opportunity to discuss the views of our members on the application for federal deposit insurance by the proposed industrial loan company (ILC), Wal-Mart Bank, to be established in Salt Lake City, Utah.

ACB believes that depository institutions of all types should have the ability to choose the charter that best suits the needs of their customers and business model. While ACB supports the existence and viability of the ILC charter as an option, we oppose Wal-Mart's application for an ILC and federal deposit insurance for the following reasons. First, we believe ILCs must operate under restrictions substantially similar to those Congress placed on unitary savings and loan holding companies organized after May 4, 1999. Restrictions on ILCs are now pending in Congress, and the FDIC should not act until Congress fully considers the issue. Second, we are

¹ America's Community Bankers represents the nation's community banks of all charter types and sizes. ACB members pursue progressive, entrepreneurial and service-oriented strategies in providing financial services to benefit their customers and communities.

concerned that if the Wal-Mart Bank expands unchecked, the competitive advantages of the company will diminish competition in markets now served by community banks, thereby leaving local businesses that compete commercially with Wal-Mart with no community-based banking alternative. Finally, we believe that the size and concentration of a Wal-Mart Bank in the payment system, and deposit insurance fund more generally, present serious questions of systemic risk.

Congress has established clear limitations on the separation of banking and commercial firms. Prior to 1999, the U.S. banking laws did not restrict non-financial companies from owning and operating savings associations. In 1999, the Gramm-Leach-Bliley Act placed restrictions on commercial companies that derive on a consolidated basis more than 15 percent of their gross revenues from activities that are non-financial in nature. Representatives Paul Gillmor and Barney Frank have included similar restrictions on ILCs in H.R. 1224, the “Business Checking Freedom Act of 2005,” which overwhelmingly passed the House. More recently, similar restrictions and limitations on interstate branching by commercially-owned ILCs were included in H.R. 3505, the “Financial Services Regulatory Relief Act of 2005.” Clearly, Congress is aware of certain public policy concerns regarding ILCs and is moving to resolve these concerns. We agree with Federal Reserve Board Chairman Bernanke that the extent of nationwide powers available to ILCs is for Congress to decide. The FDIC should not act on the Wal-Mart application before Congress has an opportunity to fully consider this legislative issue, particularly given potential risks to the banking and payments systems.

Community banking is a vital sector of the U.S. economy. Community banks provide essential services for their local customers who may prefer to bank with a local institution that knows their community, their interests and their credit needs. Therefore, despite the recent trend

toward consolidation in the financial services market, there remain almost 9,000 depository institutions in the U.S. While ACB is committed to fair and open competition among all institutions, we note that some competitors of community banks operate with regulatory and tax advantages not available to community banks. For example, community banks bear a greater relative burden of regulatory costs compared to large banks. In the face of the skyrocketing costs of complex regulatory requirements, many community banks have sought mergers with larger institutions. To approve Wal-Mart's application today lays the groundwork for Wal-Mart to expand into full retail banking without additional regulatory approval, thereby further threatening the viability of community banks. Nothing would prevent Wal-Mart Bank from expanding its activities once this application is approved.

The Utah Department of Financial Institutions notes that most operating ILCs "have taken advantage of Utah's Consumer Code and marketed specialized products and services nationwide." They also note that ILCs are authorized to make all kinds of consumer and commercial loans and to accept federally insured deposits, adding that "ILC activities and powers are not as restricted as commercial banks."

In addition, we note Wal-Mart Bank reportedly has withdrawn its request for an exemption from the requirements of the Community Reinvestment Act (CRA) on the basis of its limited business model as submitted in its deposit insurance application, and now proposes to be fully subject to CRA requirements in a designated CRA-assessment area. This strongly suggests an intended retail strategy that would pit Wal-Mart Bank against thousands of community banks, magnifying all of the inherent conflict of interest, competitive advantage and systemic risk concerns that we raise here today. The exposure of these community banks is perhaps best illustrated by considering the impact on over 1,000 community bank branches operating in Wal-

Mart stores. Hundreds of these banks are ACB members. Most of these banks enjoy good business relationships with Wal-Mart through agreements under which they lease space inside Wal-Mart stores. These relationships are good for community banks and customers of Wal-Mart. However, these community banks' business strategy is clearly at risk if their branches inside Wal-Mart were eventually displaced by Wal-Mart banks that are established as a result of FDIC's approval of Wal-Mart's application for deposit insurance, and operate henceforth with unfair advantages and conflicts compared to community banks.

In summary, the long-term ramifications for availability of credit for small businesses that compete with Wal-Mart in the commercial market would be severe in communities across the country if community banks were displaced by retail Wal-Mart banks which will have an inherent and unavoidable conflict between the merchandising needs of the Wal-Mart parent and the credit needs of local businesses. Consumers in those communities would also suffer because their choices among financial institutions and financial products would be more limited, and less competition eventually could mean higher prices for services.

Finally, the sheer size of Wal-Mart's business, with over \$300 billion in revenue in 2005, raises serious questions of systemic risk in the payments system as well as for the deposit insurance fund more generally. As just one example, according to Wal-Mart's application, its bank would process billions of transactions as a credit card acquirer. The role of the acquirer (in this case Wal-Mart Bank) under current rules is to ensure that the merchant (in this case Wal-Mart stores) meets merchant qualification standards and is engaging in legitimate business. With the Wal-Mart Corporation on both sides of these transactions, there would be a conflict of interest that could place the consumer at risk. Further, it would be challenging, and potentially impossible, to ensure that there would be effective firewalls against financial problems in the

commercial store spreading to the Wal-Mart Bank. In such a scenario, with hundreds of billions of dollars passing through the Wal-Mart Bank system, the risk of disruption stemming from financial problems at Wal-Mart would be great. The high number of transactions and the large dollar volume in this case increases the importance of the need for the acquirer and merchant to be independent and free of influence from each other.

We recognize the FDIC as a strong, effective and diligent regulator. However, as the GAO has recently noted, ILCs may present a higher risk of loss to the deposit insurance fund because, unlike the OTS and the Federal Reserve, the FDIC was not established by Congress as a holding company regulator. Therefore, the Wal-Mart parent would be subject to fewer requirements than other similarly situated institutions, giving the company an unwarranted regulatory advantage and posing a safety and soundness risk to the banking system. Allowing Wal-Mart to operate outside the statutory requirements that have been carefully crafted for other institutions is a risk in and of itself due to the extraordinary size of the company. This is a risk that the FDIC should avoid at all costs.

We also note that the Wal-Mart Bank will offer short-term certificates of deposits to two classes of depositors: 1) non-profits, charitable and education organizations designated as 501 (c)(3) entities by the IRS; and 2) individual investors generated through deposit brokers. Given Wal-Mart's size, its ability to generate a significant volume of insured deposits poses a threat to dilute the deposit insurance fund. In the past, other large ILCs contributed to the dilution of the Bank Insurance Fund without contributing any reserves, thereby weakening the deposit insurance fund. This "free-rider" problem cannot be permitted to continue – particularly with the size and scope of Wal-Mart's operations.

Conclusion

I wish to again express ACB's appreciation for your invitation to testify on Wal-Mart's application for deposit insurance. As this application represents a topic that is under active consideration by Congress and also presents an extraordinary and unusual set of facts and risks, ACB strongly urges the FDIC to disapprove the application at this time.